

Aurizon Operations Submission to the Consolidated Draft Decision on Aurizon Network's 2014 Draft Access Undertaking

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Aurizon Operations Submission to the Consolidated Draft Decision on Aurizon Network's 2014 Draft Access Undertaking

Overview

Aurizon Operations (**Aurizon**) welcomes the opportunity to respond to the Queensland Competition Authority's (**QCA**) consolidated draft decision (**CDD**) on the 2014 Draft Access Undertaking (**2014DAU**).

Aurizon's response to the CDD is strongly guided by a preference to obtain appropriate levels of regulatory and commercial certainty through the expeditious approval of the 2014DAU. The submission primarily focuses on promoting and facilitating productivity and efficiency improvements in the provision of rail services in the Central Queensland Coal Network (**CQCN**).

The overarching goal of the regulatory framework is to facilitate these outcomes through promoting competition and the incentives necessary to pursue innovation and continuous improvement for the long term benefit of the Queensland coal industry.

Aurizon is committed to taking the least resource intensive approach to its operations to deliver long term productivity improvements. A core part of our strategy is a multi-year, world-leading transformation program across all our operations. Our Integrated Operating Plan (**IOP**) is the cornerstone of this transformation. The IOP is a process by which Aurizon seeks to drive continuous, sustainable and repeatable improvements in our core business to deliver reliable and cost effective rail haulage solutions to our customers.

An essential component of the IOP is to improve efficiency of operating costs and increase asset utilisation by optimising the use of each train path and maximising train payload. This has produced significant improvements across the CQCN with an average increase in train payload of 3% in FY2014 which has in turn increased overall system capacity at very little, or no, cost.

Improving the efficiency of the above rail operations and providing longer term improvement in the competitiveness of Queensland coal producers should be a key objective of the access regime. The access undertaking, subject to protecting the interests of existing users, should seek to promote efficiency through competition by facilitating commercial and operational innovation by rail operators and access seekers.

Aurizon is of the view that the CDD does not achieve these objectives for a number of critical reasons:

1. The absence of the ability for access seekers to relinquish excess train paths associated with above rail productivity improvements without incurring costs greater than the additional cost to the system;
2. The absence of the ability of operators to obtain and maximise the efficiency benefits of its operational improvements through capacity transfers and flexibility to manage Take Or Pay (**TOP**) liabilities;
3. The disproportionate difference in access charges for services using the overhead power system relative to equivalent diesel train services is inconsistent with promoting efficient utilisation of part of the declared service; and
4. The lack of appropriate confidentiality arrangements to protect an operator or access seeker's commercially sensitive information regarding its innovations.

This submission establishes the reasons for these conclusions and suggests effective recommendations as to how they can be addressed to better align to efficiency and competition objectives. Regulatory frameworks that are overly prescriptive can stifle innovation because they cannot predict and efficiently reward the benefits of productivity improvements which naturally extend from allowing supply chain participants to seek better outcomes in their own manner.

While this submission addresses only the matters discussed above it should not be concluded that the exclusion of any aspect of the CDD from this submission reflects Aurizon's agreement with QCA's assessment of the 2014DAU against the requirements under s.138(2) of the *Queensland Competition Authority Act 1997 (the Act)*.

Aurizon supports effective regulation which strikes an appropriate balance between coordination and competition. Coordination necessarily reduces the scope for competition and there is an inherent trade-off between short and long term efficiency objectives. An increased weight towards coordination should be the outcome of quantitative evidence-based decision making. Therefore, the final decision should have a stronger focus towards promoting competition given the incentives of the supply chain participants to coordinate their operations without regulatory intervention and control.

The relinquishment of capacity should provide incentives to improve the efficient utilisation of the declared service

Aurizon's previous UT4 submissions have raised concerns that the payment of relinquishment fees due to additional capacity being created as a result of operator's productivity improvements would have unintended consequences. Where there is no alternate demand for the capacity created through the improvements in above rail productivity the payment of a relinquishment fee is:

- disproportionate to the cost imposed on the system; and
- may materially exceed efficiency benefits and reduce incentives to pursue productivity improvements.

In order to overcome these challenges Aurizon proposed that:

- the undertaking be amended to allow Aurizon Network to waive the proportion of the relinquishment fee relating to the net tonne and net tonne kilometre components;
- the undertaking include the ability for the affected access holder to present a cost/benefit assessment to allow the train path component of the relinquishment fee to be partially or fully waived; and
- the undertaking include appropriate amendments within the Standard Access Agreement (**SAA**) which specifically exclude the requirement to pay a relinquishment fee on the net tonne and net tonne kilometre components of TOP where the relinquishment corresponds to above rail productivity improvements.

The CDD rejects these proposals on the basis that the QCA believes it:

would have the effect of shifting a portion of costs of making efficiency gains onto the network. We do not consider it appropriate that the benefits of efficiency gains are kept by one access holder, while the costs associated with the transaction are socialised¹.

Aurizon does not agree with this assessment. In relation to these proposals, the CDD does not evaluate how the proposal would be reflected in reference tariffs or TOP and does not demonstrate how a cost transfer would occur.

The following worked example quantitatively demonstrates why the relinquishment fee is materially disproportionate to the revenue differential arising from the above rail productivity improvements.

¹ QCA (2015) CDD, Vol. 2, p.85

Figure 1. Worked Example of Relinquishment Fee

- | | | |
|--|---|--|
| <p>1 IOP results in reduction in total demand for paths</p> <ul style="list-style-type: none"> Increased train length would release 1 daily loaded path. Additional four wagons in Goonyella increases train productivity by 3.3% | <p>2 No reduction in net tonnes, but less paths consumed</p> <ul style="list-style-type: none"> AT3/AT4 revenue is unchanged – same tonnes railed. Less AT2 revenue received. Difference in AT2 revenue from 100% change in train lengths is less than \$2 million. Difference on access charge per train service from reduced paths is less than \$0.02 per net tonne. Negligible impact on gross tonne kilometres | <p>3 Relinquishment fees grossly disproportionate to costs</p> <ul style="list-style-type: none"> Total relinquishment fee ~ \$7-8 m per annum, if 100% of Goonyella trains are lengthened. Total relinquishment cost will be tens of millions (over the term of access contracts). |
|--|---|--|

Relinquishment Fee Workings

$$(UT2^+) \text{ Relinquishment Fee} = 0.5 \times [TP \times AT2 + NTK \times AT3 + NT \times AT4]$$

AT2 = 16% of Allowable Revenue	AT3 + AT4 = 77% of Allowable Revenue
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- 3.3% Δ in Train Paths	0% Δ in net tonnes and net tonne kilometres
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Path Productivity Change Workings

$$\text{Productivity Change \%} = \frac{[\text{Total Payload Current}]}{[\text{Total Payload Proposed}]} - 1$$

$$\text{Train Payload} = \text{Wagons} \times \text{Wagon Payload}$$

Assumptions

- All revenue, volume and tariff assumptions based on Aurizon Network UT4 Public Model – Goonyella system
- 3.3% payload efficiency applies across all services
- Relinquished contracted train paths based on [140 mtpa / average nominal payload] * 3.3%
- Tariff and revenue adjustments made on proposed UT4 2013-14 figures following proportional revision of forecast train path values

The worked example clearly demonstrates that the aggregate net tonne and net tonne kilometres (the majority of the reference tariff) in access agreements are unchanged. Therefore, the TOP liability in that agreement is reduced only by the charges on the number of train paths not paid as a result of operating less services to transport a fixed tonnage profile. Similarly, the expected access revenue from the AT3 and AT4 revenue components earned under the access agreement is identical pre and post relinquishment with the system forecasts independent of the contracted tonnes.

The QCA’s concerns regarding cost transfer, relative to productivity improvements, can largely be addressed by limiting the relinquishment fee to the AT2 component of the TOP charge.

In respect of the AT2 component there is also a need to consider the broader system benefits including:

- the reduction in train paths consumed for the same tonnage task can reduce system congestion and improve transit times;
- the increase in available train paths can be used for increased or more flexible maintenance access;
- the increase in available train paths can increase system surge capacity to rail more tonnes during peak periods;
- the improved above rail productivity improves the probability of ports achieving nameplate capacity;
- providing additional opportunities for the operation of ad hoc services (including non-coal freight services); and
- reduction in the scope or deferral of subsequent capacity expansions.

The latter point is relevant to the reasonableness of the relinquishment fee which has a purpose of providing a consequence to access holders for not railing contracted tonnages. However, where an

operator or access holder is required to pay a relinquishment fee for improving its productivity and increasing the feasible capacity of the system, it does not receive compensation for the creation of that capacity where it is later contracted by another party. For example, if the relinquishment fee is calculated over a duration of five years and the capacity is then contracted by another party after two years, the original operator is not compensated for the increased revenue collected by Network due to the train services run in the latter period. In this case, this is only possible due to the productivity improvements of original operator and the subsequent uptake of surplus paths by new access seekers. Costs and benefits should be assessed against a longer term view of the commodity cycle. Having regard to these factors there is a prima facie case for the full or partial waiver of the AT2 component of the relinquishment fee.

Aurizon's proposal is consistent with the statutory objectives of the access regime as:

- increased train lengths improve the productivity of existing trains paths and thereby promote the economically efficient use of rail infrastructure;
- it allows rail operators to improve efficiency and consequently the competitiveness of rail services with the effect of promoting competition in the downstream rail haulage market;
- it ensures the pricing framework is consistent with providing incentives to reduce cost and improve productivity within the supply chain; and
- it reduces the overall cost structure of the Queensland coal industry and thus assists in improving the competitiveness of the Queensland coal producers and promotes the public interest.

Aurizon also notes that the matter may be relevant to the future review of the tariff structure. If the objective is for rail operators to not pursue efficiencies through longer trains and increased payloads then the use of train path charges would be in conflict with this objective.

Similarly, the underlying drivers associated with the baseline capacity assessments would appear incompatible with any concerns regarding the relinquishment of train paths from improvements in above rail productivity. Increasing system capacity leads to efficiency improvements within the CQCN and without the need for excessive capital infrastructure investment by the access provider.

Recommendations

Aurizon encourages the QCA to adopt its proposals in the final decision and to consider more broadly the interaction of policy and pricing decisions to avoid conflicting incentives. The final decision should include appropriate amendments to Schedule F of the Undertaking to allow Aurizon Network:

- to waive the collection of the AT3 and AT4 components of the relinquishment fee where there is no material reduction in the contracted net tonne and net tonne kilometres are (as reflected in the revised nominal train configuration);
- to waive the collection of all or part of the AT2 component (with approval by the QCA) of the relinquishment fee where it can be demonstrated that there are benefits to the system from the relinquishment (i.e. through supply chain improvements, promotion of competition and capacity release without capital investment).

Capacity transfers promote competition and help access holders manage risk

Aurizon welcomes the QCA decision not to impose a transfer fee for transfers which are primarily aimed at improving contractual and operational certainty in response to short term fluctuations in supply and demand across all elements of the supply chain. Importantly, the continuation of socialisation of volume risk within the CQCN is consistent with this approach.

Aurizon has previously recommended (and provided practical examples of completed transfers to the QCA on a confidential basis that were not acknowledged by the QCA in the CDD) that the framework for short term transfers provide as much flexibility as reasonably practicable and within acceptable limits to the access provider in relation to its own contractual liabilities regarding the provision of access. This necessitates the access provider retaining some discretion as to whether a transfer can be accommodated. The greater the degree of prescription required on permissible transfers the more restrictive the framework becomes to apply. In this regard, the QCA's approach in relation to Criteria B transfers that are subject to a rapid (48 hour) capacity assessment would allow consideration of a broader scope of feasible transfers. However, this approach must satisfy two conditions:

- it must be feasible for the access provider to undertake the assessment within those timeframes with a reasonable degree of confidence regarding the potential impacts on network capacity and adverse effects on other access holders; and
- the administration of the framework must not adversely affect Aurizon's ability to compete in the rail haulage market by providing competitors increased levels of flexibility which cannot be replicated due to statutory restrictions on the variation or amendment of access agreements with the related operator.

Aurizon is of the view that the final decision will need to meet these conditions in order to ensure that a related party operator's ability to compete is not materially adversely effected.

The proposed reduction in the transfer period from two years to three months before a transfer fee would be payable is not supported by Aurizon. While conceptually it is feasible to request repeated short term transfers of three months to achieve a similar outcome, this comes with a degree of uncertainty as to the availability of the capacity over that term and imposes a substantially greater administrative burden. There is also legal uncertainty as to whether the Undertaking can amend the terms of an existing access agreement. This then raises the prospect that only UT4 agreements would be subject to the revised arrangements with access holders holding UT4 access agreements being competitively disadvantaged relative to holders of UT3 access agreements and the amended UT1 and UT2 agreements² which are subject to no transfer fee for transfers of terms of less than two years.

The requirement that a transfer fee apply where the services are subject to different reference tariffs may not provide an equitable outcome for producers who are subject to a system premium. There are potential asymmetric consequences for producers where a transfer fee is payable to transferring paths but there is no consequential reduction on the system premium where it obtains additional paths. Similarly, the

² See QCA in principle decision of 18 February 2016 to allow UT1 and UT2 agreements to be amended to include these provisions.

producer may also be penalised by way of a transfer fee and subsequent increase in the system premium during the annual price reset.

The CDD also rejected the proposals regarding operator capping on the basis that:

- the capacity trading mechanism provides a more appropriate mechanism to allow users to efficiently manage TOP liabilities; and
- it could favour a large, related operator over smaller operators.³

Aurizon's submission of 17 April 2015 acknowledged that the original 2013DAU proposal for operator capping was overly complex due to the requirement for the capping formulas to have regard to the utilisation of access rights across multiple agreements and customers. In response to this complexity, Aurizon suggested that capping could still apply to the aggregate train service entitlements within a single access agreement.

The primary objective of the proposed capping was to allow the benefits of operational performance and efficiency to be captured by the rail operator and its customers prior to the benefits of any over-railing being fully reflected in the system cap. This is intended to provide stronger incentives for the rail operator to improve efficiency through better coordination of its operations with customers and to promote competition in the rail haulage market through more efficient utilisation of rail infrastructure.

Many of the circumstances which might give rise to an origin-destination combination railing above its contracted train service entitlements may not necessitate the use of a capacity transfer. Transfers will involve a transaction cost which can be avoided where there is sufficient available capacity. Similarly, the over-railing may be immaterial and not foreseeable due to the operation of ad hoc services required to manage coal quality and short term production variability. Therefore, while the transfer framework could be used to limit TOP liabilities it may not be necessary or desirable to do so.

Aurizon is of the view that any concerns regarding the aggregate capping of TOP within an access agreement having a discriminatory effect between access holders are not supported by evidence or market analysis to substantiate that conclusion. The CDD did not consider the following factors:

- while an increase in the number of train service entitlements in an access agreement may increase the probability that one or more services may exceed net entitlements for an individual origin-destination combination, the converse would also be true; that the inclusion of more train service entitlements in an access agreement would increase the probability that some hauls would fall short. Accordingly, the benefits of over-railing on some hauls would be diminished due to the distribution of these benefits over a larger number of hauls (diseconomies of scale);
- the benefits that can be realised and are likely to be greatest with only two origin-destination combinations and the barriers to entry in the above rail market may not support entry for one mine (due to the need for a minimum scale to establish an efficient rail operation); and
- scale can be replicated by smaller operators and producers through innovation and cooperative models.

The CDD is also implicitly contradictory in that it argues that the benefits of operator capping could be replicated through the capacity trading framework. The factors listed above do not support a conclusion that introducing aggregate TOP capping within an access agreement would have the effect of

³ QCA (2015) CDD, Vol. 3, p.215

differentiating between access seekers in a material way or acting as a barrier to promoting effective above rail competition.

In particular, if the proposed changes to the transfer framework are implemented, it would not be economically feasible for the proposal to have those effects.

Aurizon also notes that aggregate TOP capping would achieve a similar outcome to the ad hoc charge rebate which operates in access agreements in the Hunter Valley Coal Network. In this case, ad hoc railings offset origin-destination combination obligations before contributing to system obligations. Aurizon also notes that stakeholders have not raised extraordinary concerns regarding scale of rail operators.

Aurizon maintains that the original policy objective of strengthening the incentives for rail operators to improve their throughput from their (or their customers) contracted access rights is consistent with promoting competition and efficiency. These objectives are more readily achieved by ensuring that productivity benefits from increased throughput accrue to those who achieve them

The introduction of aggregate TOP capping is not overly complex and requires minor amendments to the SAA such that invoiced TOP amounts are net of excess revenue. The TOP liability prior to any system capping would be equivalent to the net difference between the total revenue expected to be earned from the contracted train service entitlements and the actual revenue earned from services operated under the agreement.

Therefore, Aurizon recommends that the final decision include appropriate modifications to allow for revenue from the operation of ad hoc train services to be attributed to reducing TOP liability within an access agreement prior to the calculation of system capping.

Recommendations

The final decision should include appropriate amendments which:

- retain the ability to transfer access rights for a period of two years without incurring a transfer fee;
- ensure Aurizon Network is able to achieve the assessment timeframes;
- ensure all operators, including a related operator, are able to take advantage of the mechanism despite statutory obligations regarding arm's length dealing;
- ensure users subject to system premiums are not subject to inequitable and asymmetric outcomes; and
- modify the TOP arrangements in an access agreement to allow for the calculation of TOP on the basis of aggregate access revenue in the agreement prior to the application of system capping.

Prices should support the efficient utilisation of overhead power systems

Aurizon's submission in response to the draft decision on WIRP pricing of 7 October 2015 sought clarification on the range of input assumptions which have been relied upon to determine the AT5 tariff that will apply to electric traction services originating from the Rolleston mine.

The request for the clarification originated from the requirement for Rolleston services to pay an AT5 tariff greater than the system AT5 tariff. This outcome appears broadly inconsistent with prior submissions on AT5 that highlight Aurizon's concerns with electric and diesel traction being differentiated. The 2013DAU suggested that the electric train volumes for the Rolleston mine would have derived sufficient revenue to meet incremental costs and contribute to a reduction in the system price. Similarly, the Blackwater AT5 tariff appeared lower than the proposed tariffs in the 2013DAU. The combination of these factors supported an inference that Rolleston is being required to make a contribution to common costs.

The CDD indicates that the Rolleston AT5 tariff is based only on the incremental costs, including a proportion of the WIRP electric expansion costs and may not be making a contribution to the broader system costs. This suggests that the AT5 tariffs for Rolleston and other users in the Blackwater system are significantly influenced by either revenue smoothing or volumes, neither of which are sufficiently transparent for stakeholders to form any view of their reasonableness. Similarly, the QCA has not considered the clear empirical evidence of the benefits to existing users through the improved energy efficiency associated with the incremental Rolleston volumes.

The reliance by the QCA on a single economic consultant for volume forecasts without adequate disclosure or robust scrutiny materially increases regulatory risk and the prospect of regulatory error. Aurizon maintains a view that all QCA models and assumptions should be provided to the access provider to allow the party giving the undertaking to have sufficient information to assess the CDD against the requirements of section 138(a) of the Act and to allow it to comply with various obligations in the undertaking which would rely on the use of that information.

The key parameters and input assumptions associated with the derivation of the respective AT5 tariffs is also necessary for access seekers to assess the long term pricing pathways for investment in electric traction. This requirement becomes even more imperative where short term movements in diesel prices may promote less efficient investment.

Aurizon's submission on the draft decision on the 2014DAU⁴ and its submission to the draft decision on WIRP pricing both raised significant concerns with the proposed AT5 tariffs in the Blackwater system including:

- The use of a fully distributed cost pricing model is not appropriate for substitutable services;
- The application of the objects clause in section 69E of the Act does not extend to promoting competition for the declared service;
- The cost associated with AT5 for an individual access holder should not be dependent on the traction choice decisions of other users of the declared service;
- The deferral of revenue associated with the application of an efficient price will only reduce the efficiency of future prices and represent an asymmetric risk to current users of electric services;

⁴ Submission dated 17 April 2015

- The pricing arrangements must not preclude the service provider from recovering its efficient investment; and
- There is a need to obtain objective evidence of the performance differential between electric and diesel powered locomotives.

These submissions provided detailed supporting arguments and assessment against the requirements of section 138(2) of the Act. However, the CDD does not address these matters in a substantive way even though a key principle strongly advocated in the CDD is that costs associated with investment in the network should not be transferred to other users as a consequence of one or more users not utilising their contracted capacity.

Aurizon does not see the distinction of this objective and the determination of an efficient AT5 tariff. The overhead power system in the Blackwater system was expanded on the basis of industry consultation and endorsement of the investment⁵. This endorsement was subsequently relied upon by Aurizon to invest in electric traction locomotives with the continued objective of improving the efficient utilisation of the infrastructure to lower the average cost of common user infrastructure, which is progressively being realised.

This can be contrasted with the different environment that would have prevailed had the expansion not occurred. The Regulatory Asset Base assets prior to the expansion of the overhead power system would now have been largely life expired and the consequential AT5 tariff would have largely reflected a very low marginal cost. In the circumstances the reciprocal debate would have sought to address the apparent unfair cost advantage that would have been held by Aurizon due to the existence of an affordable overhead power system within a capacity constrained corridor in which Aurizon is the majority Access Holder. Aurizon considers that the circumstances in a post expansion environment warrant a similar level of regulatory attention that would likely have prevailed had the expansions not occurred.

Therefore, Aurizon maintains that the CDD in relation to the AT5 tariff for the Blackwater system:

- does not establish an efficient AT5 tariff;
- does not promote competition in the rail haulage market;
- incorrectly promotes competition for the declared service; and,
- does not promote efficient utilisation of the overhead facilities.

Aurizon recognises that the QCA may prefer to defer the consideration of these matters to coincide with a broader price structure review under UT5. This should not preclude the QCA ensuring that the final decision adequately addresses the arguments identified above and provides appropriate guidance as to the economic and legal principles that must be satisfied in that review. Issues in the pricing of AT5 were noted in 2011⁶ and remain largely unresolved following multiple regulatory processes which have each suggested that more work be done in the future. This deferment cannot continue indefinitely.

In the event that this final decision once again defers the consideration of this matter, the QCA should at the very least restate the principles upon which a future solution will rest. Of equal importance, the QCA should ensure that the Undertaking includes adequate measures which provide for users of electric traction in the Blackwater system to be compensated for any economic losses arising from past and continued deferral. Any change in the approach to pricing AT5 services which would reduce the AT5

⁵ QCA (2009) Final Decision: Regulatory pre-approval for Coal Master Plan 2008 capacity expansion projects, 23 April

⁶ QR Network (2011) Draft Amending Access Undertaking, Electric Traction Pricing, December

tariff, if applied retrospectively to 1 July 2015, should effect a return of capital to affected access holders. The means of funding this return of capital should be determined as part of the review.

Recommendations

Prior to making a final decision the QCA should ensure it has provided the access provider with sufficient information regarding the essential inputs into the determination of the Rolleston AT5 tariff and provided opportunity for the access provider to submit evidence to address any material errors in those inputs.

The final decision should include appropriate amendments which achieve the following principles:

- determine efficient AT5 tariffs based on the forecast gross tonne kilometres (**GTK**) which operate between an electrified origin and destination; and
- adequately and effectively address any consequential revenue shortfall from differences between the relevant forecast GTK and the forecast electric GTK to the access provider without having a distortionary impact on traction choice or discriminatory impact between system users.

If the QCA is of the view that it is necessary to defer the approval of these positions to a subsequent review process then the final decision should:

- include appropriate directions that any future review of AT5 pricing must be consistent with the above principles;
- ensure that users of the Blackwater overhead power system be compensated for any difference between the applied AT5 tariff and any reductions that would have applied from the commencement of the first principle from 1 July 2015; and
- ensure that the funding of that compensation is consistent with the second principle.

The protection of confidential information is essential to innovation and promotion of competition

The objectives of the access regime are to promote the efficient operation of, and investment in, significant infrastructure with the effect of promoting competition in an upstream or downstream market⁷. This primacy of competition is reflected in the access criteria in section 76(2) of the Act which states that:

access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service.

The competitive mechanism generally requires that market participants who use the declared service undertake innovation designed to improve all aspects of efficiency with the most important being dynamic efficiency. To meet these objectives rail operators require confidence that information relating to how they use, or propose to use, the declared service will be subject to effective protection of confidential information.

Aurizon welcomes the CDD's recognition of this point:

Confidentiality is important to an access agreement's contracting parties. It helps them retain their competitive advantage by preventing disclosure of commercially sensitive information to competitors (and potential competitors)⁸.

The QCA notes that the baseline capacity assessment cannot reveal confidential information unless Aurizon Network and relevant stakeholders agree, or are taken to have agreed, to the disclosure of that information. The CDD notes that this should be sufficient to address Aurizon's concern that the Undertaking should not permit the disclosure of information without the owner's consent. Nevertheless, the QCA conversely maintains the position that Aurizon Network should be prohibited from entering into any confidentiality agreements which prevent the disclosure of information contained in the Baseline Capacity Assessment Report⁹.

Aurizon remains concerned that the effect of this restriction is to circumvent the rights of the owner of confidential information to withhold consent if that information is relevant to the determination of capacity. It is reasonable to conclude that how an operator uses, or proposes to use, the declared service would be relevant to the determination of capacity and therefore might reflect an Aurizon Network assumption affecting capacity as based on the rail operator's confidential information. As a consequence, the drafting in sections 7A(4.1), 7A(4.2) and 7.5(h) of the Undertaking should be amended to remove doubt that the baseline and subsequent capacity assessments, and any consequential variations to the system operating parameters, must not include an access holder or access seeker's confidential information.

Aurizon also has concerns that Aurizon Network's inability to agree to confidentiality with parties who are not otherwise an access holder or an access seeker may provide disincentives for those parties to provide information to the access provider. This would be contrary to the broader objectives of supply chain alignment. For example, if ports decided to restrict the information they provide to Aurizon Network to protect commercially sensitive information from a competing port operation this action would likely impact supply chain efficiency.

⁷ Section 69E of the QCA Act

⁸ QCA (2015) CDD, Vol. 2, p.26

⁹ Proposed clauses 7A.4.1(j), 7A.4.2(i) and 7.5(h) of the CDD Access Undertaking

Where an operator or user seeks to undertake innovations or improvements in operating practices which could vary the system operating parameters then any consequential review of the system operating parameters should not include disclosure of any relevant confidential information. For the avoidance of doubt:

- the access provider should not be required to disclose confidential information relating to how the rail operator operates, or proposes to operate its train services without consent; and
- the QCA should not be required to make changes to the system operating parameters which adversely affect the legitimate interests of the rail operator to improve the efficiency and competitiveness of its rail haulage services.

Innovation by rail operators may involve commercial and operational initiatives with the access provider, on an arm's length basis, which are able to provide a competitive advantage through either a reduction in cost or risk, or through service differentiation which has value to the customer. The Undertaking substantially interferes with the ability of an access seeker to pursue such innovations due to the restrictions or limitations regarding price differentiation where a Reference Tariff applies as per clause 6.2.3 of the Undertaking.

As a general principle, variations from the reference terms and conditions should be permissible where they do not involve cost or risk transfer to other users of the declared service. Aurizon conceptually accepts that it may be difficult to provide a variation which involves the access seeker accepting a greater risk in exchange for a lower tariff. As a consequence, clause 6.2.3 of the Undertaking is only concerned with those circumstances where the access provider incurs higher cost or risks and only where the terms and conditions are approved by the QCA as an access condition pursuant to clause 6.13 of the Undertaking.

The process required to obtain the QCA's approval for different terms and conditions (i.e. where an access seeker voluntarily forgoes the safe harbour provisions of the reference tariff and reference service) does not protect a rail operator's confidential information. Clause 6.13.1 of the Undertaking, which defines the use of access conditions, incorrectly frames the access conditions as mitigating a cost or risk as opposed to the commercial objective of compensating the access provider for additional cost or risk. The process for determining reference tariffs is based on the assumption of a benchmark allocation of cost or risks. It presupposes that an access seeker cannot obtain a more efficient allocation of cost and risk through negotiations which reflect its individual circumstances.

Clause 6.13.2 of the Undertaking also requires that where an access seeker moves to negotiate different terms or conditions of access from the reference service that the QCA is obliged to invite and consider comments from relevant stakeholders. The suggestion is vague and contrary to the legitimate interests of both the access provider and the access seeker who wish to, in confidence, negotiate operational changes (or pursue rollingstock innovations) which will improve the competitiveness of the access seeker's service in the competitive market. Aurizon is of the view that any requirement to consult, or disclose an access seeker's or an access holder's confidential information in relation to proposed variations from the reference train or the reference terms and conditions is inconsistent with promoting the principal objective of the access regime which is to promote competition.

Where an access seeker moves to enter into an access arrangement which is different from an established reference tariff, then the access provider should only be required to provide the QCA a report which addresses how the proposal does not increase the costs or risks of other access seekers.

Recommendations

The final decision should ensure that incentives for innovation and the competitive process is not impaired due to the compulsory disclosure of confidential information. Where the disclosure of this

information is intended to address perceived deficiencies in stakeholder confidence on capacity assessments then the final decision should evaluate alternate mechanisms for achieving those objectives.

The final decision should also not require the public disclosure of any matters relevant to the negotiation of new (or the variation of existing) access rights. The QCA should rely on its information gathering and auditing powers under the Act to ensure compliance with obligations related to the protection of third party interests.